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SUBJECT: TURKEY: ELECTRICITY PRIVATIZATION POSTPONED UNTIL AFTER
ELECTIONS

REF: Ankara 6410 and previous

11. (SBU) Summary: Confirmation that the Government has decided to postpone electricity distribution company privatizations planned to begin this month put a damper on markets at the start of the new year. The reason for the delay appears to be the political desire of the AKP Government to avoid electricity price increases, which privatization would have entailed, during an election year. The postponement will make it harder to find a solution to Turkey's expected tight supplies of electricity in coming years, sends a negative signal about economic reforms, and could create problems for the IMF program. End Summary.

Government Postpones Privatization

12. (SBU) The long-awaited privatization of the first three regional electricity distribution companies has run into election-year political pressures. Prime Minister Erdogan shocked markets and the business community January 4 by implying that the privatizations would be postponed. On January 9, Energy Minister Guler confirmed publicly that the privatizations would not go forward until after the November parliamentary elections. Seventy-nine pre-qualified companies were already examining information about the companies in the "data room," and as recently as December 21, Privatization Authority President Metin Kilci told us he expected the bid deadline of January 19 to hold.

The Devil is in the Electricity Price

13. (SBU) In his January 9 statement, Guler emphasized the importance the GOT gives to infrastructure, and set forth the GOT's underground wiring project as the reasons. But it seems clear to all observers that the driving factor behind the government's hesitation is fear of the electoral impact of an election year price increase for consumers of electricity. Electricity prices have not increased in Turkey since 2002 and have not kept up with the dramatic increase in global energy prices since then. In order for the privatized entities to be financially viable, the government would have to allow significant price increases.

Question Marks About Supply Adequacy, IMF Program

14. (SBU) The Government's decision leaves many questions unanswered.

IMF officials told us in November that they had secured Economy Minister Babacan's agreement to seek Government approval of electricity and gas price increases to shore up the finances of the state-owned energy companies. The IMF did not make price increases an explicit condition of its program, but Fund staff doubt the Government can achieve the 6.5% 2007 primary surplus target for the entire public sector without electricity and gas price increases. The primary surplus is the cornerstone of the IMF program and the main indicator the Fund and markets look to in assessing Turkey's compliance.

15. (SBU) Electricity distribution privatization was also important to deal with Turkey's looming domestic power crisis. As strong economic growth continues, most analysts foresee supply tightness beginning as soon as 2008 or 2009 given the lack of significant upgrade in generation capacity since 2000. The government had hoped that private investment in the sector would help cover the gap. But that investment has not been forthcoming because of the unresolved pricing and issues that would need to be resolved before the privatizations could go forward.

16. (SBU) The distribution company privatizations were already technically difficult: one potential U.S. bidder provided us with a long list of potential problems for bidders. Even if the Government had increased prices, Kilci told us the deal was structured with a set minimum profit margin, so as to induce the buyers to get most of their upside from cost reduction. However, all these were foreseeable risk factors for the companies and they were included in their bids. The GOT's last-minute cancellation, without any commitment to eliminate these risks in the long term, is likely to have an adverse effect on the GOT's next electricity privatization effort.

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Comment

17. (SBU) The Government has generally shown political courage in selling off state-owned enterprises, despite widespread public skepticism about the benefits of privatization, and outright opposition from other political parties, the President and the judiciary. Privatizing electricity companies -- and raising prices -- in an election year was apparently a bridge too far. It may also signal a broader pause in the pace of economic reforms, as the Government takes care not to hand the populist, anti-reform opposition any new political clubs.

McEldowney